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FISCAL IMPACT STATEMENT

LS 7080

BILL NUMBER: HB 1728

NOTE PREPARED: Feb 24, 2005

BILL AMENDED: Feb 24, 2005

SUBJECT: Update of References to the Internal Revenue Code.

FIRST AUTHOR: Rep. Espich

FIRST SPONSOR:

BILL STATUS: CR Adopted - 1st House

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) The bill provides that for taxable years beginning after December 31, 2004, references in Indiana law to the Internal Revenue Code and related regulations refer to the law and regulations in effect on January 1, 2005. The bill indicates that the law that requires certain bonus depreciation allowed for federal income tax purposes to be added back for state tax purposes applies to the special depreciation allowance for 50-percent bonus depreciation property. The bill requires that "Section 179 property" deductions in excess of \$25,000 per year that are allowed for federal income tax purposes be added back for state tax purposes. It also requires a taxpayer to add back the amount that the taxpayer deducted for domestic production activities for purposes of the taxpayer's federal income tax.

Effective Date: January 1, 2005 (retroactive).

Explanation of State Expenditures:

Explanation of State Revenues: (Revised) The bill updates the reference to the Internal Revenue Code (IRC) to incorporate all the federal changes made up to January 1, 2005. The current reference to the IRC pertains to all IRC provisions amended and in effect on January 1, 2003. The update would include changes affecting tax years 2005 and after as a result of the following federal acts:

- (1) the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003 (P. L. 108-27)
- (2) the Military Family Tax Relief Act (MFTRA) of 2003 (P. L. 108-121)
- (3) the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (P. L. 108-173)
- (4) the Working Families Tax Relief Act (WFTRA) of 2004 (P. L. 108-311)

(5) the American Jobs Creation Act (AJCA) of 2004 (P. L. 108-357).

A summary of the estimated revenue impact of these federal acts is outlined in the table below. A general explanation of the provisions follows the table. It is important to note that current statute provides for an addback of federal bonus depreciation allowances claimed during the taxable year for federal income tax purposes so any references to this provision in the above acts will not affect the Indiana tax base. The bill specifies that this addback includes the 50 percent bonus depreciation allowance enacted in the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003. In addition, the bill provides for addbacks of the Section 179 property deduction in excess of \$25,000, and the deduction for domestic production activities. These provisions were enacted in the JGTRRA and the American Jobs Creation Act (AJCA) of 2004.

Provisions (Revenue Impact in \$M)	FY 2005	FY 2006	FY 2007
Military Family Tax Relief Act of 2003			
(1) National Guard Travel Expense Deduction	(0.3)	(0.4)	(0.4)
Medicare Prescription Drug, Improvement and Modernization Act of 2003:			
(1) Health Savings Account Deduction & Exclusion	(0.8)	(1.1)	(1.3)
Working Families Tax Relief Act of 2004			
(1) Educator Expense Deduction	(0.8)	(0.9)	(0.2)
(2) Clean-Fuel Vehicle Deduction	(0.2)	(0.1)	0
(3) Corporate Computer Contribution Deduction	(0.8)	(0.5)	(0.1)
(4) Expensing Environmental Remediation Costs	(1.6)	(0.9)	0
Subtotal	(3.4)	(2.4)	(0.3)
American Jobs Creation Act of 2004			
(1) Repeal of Extraterritorial Income Exclusion	1.4	5.6	15.4
(2) 85% Foreign Source Dividend Deduction	11.9	(5.1)	(8.4)
(3) S-Corporation Tax Treatment	(0.1)	(0.2)	(0.3)
(4) Business Tax Incentives and Miscellaneous Business Provisions	(2.2)	(2.6)	(2.4)
(5) Revenue Provisions	5.6	10.0	12.7
Subtotal	16.6	7.7	17.0
Total Impact on State Revenue	12.1	3.8	15.0

Military Family Tax Relief Act of 2003:

(1) Creates an above-the-line deduction for travel expenses of National Guard troops and reservists, provided the travel exceeds 100 miles and requires an overnight stay. The deductible expenses may not exceed the general federal per diem rate applicable to the particular locality.

Medicare Prescription Drug, Improvement and Modernization Act of 2003:

(1) Creates an above-the-line deduction for employee contributions to the employee's Health Savings Account (created by the Act); and creates an exclusion from the employee's gross income for employer contributions to the employee's Health Savings Account.

Working Families Tax Relief Act of 2004:

(1) Extends through tax year 2005, the above-the-line deduction for qualifying expenses incurred by educators for classroom materials (which expired after tax year 2003 under prior law).

(2) Provides for the full value of the existing above-the-line deduction for clean-fuel vehicles placed in service in tax year 2005. Under prior law, the deduction was scheduled to be reduced by 50% for property placed in service in tax year 2005. Pursuant to current law, the deduction will be reduced by 75% for property placed in service in tax year 2006, and will expire after tax year 2006.

(3) Extends through tax year 2005, the corporate deduction for charitable contributions of computer technology or equipment to elementary and secondary schools, and public libraries (which expired after tax year 2003 under prior law).

(4) Extends through tax year 2005, the deduction for expenses relating to the cleanup of hazardous substances in certain qualified areas (which expired after tax year 2003 under prior law).

American Jobs Creation Act of 2004:

(1) Phases-out the exclusion from gross income for extraterritorial income a U. S. business receives from sales of goods it produces domestically and sells abroad either directly or through a subsidiary. The phase-out of the exclusion begins in tax year 2005 and is generally complete beginning in 2007.

(2) Provides for a one-time deduction from gross income for a U. S. corporation that receive qualified dividends from a foreign corporation it controls, generally, during tax year 2004 or 2005. The deduction is equal to 85% of the amount of qualified dividends paid during the allowed time period. The dividends must be reinvested in the U. S. to fund worker hiring and training, infrastructure, research and development, capital investments, or financial stabilization of the corporation.

(3) Provisions relating to tax treatment of S-corporations, including: (a) increasing the maximum allowable shareholders from 75 to 100; (b) treating family members as one shareholder for purposes of an S-corporation; and (c) permitting IRAs to hold shares in a bank that is an S-corporation.

(4) Provisions modifying certain depreciation and accounting rules, and treatment of certain business income and expenses, including: (a) acceleration of the recovery period for certain leasehold and restaurant building improvements; (b) deduction for certain reforestation costs; and (c) 75% first year expensing (in lieu of annual depreciation deductions) of capital costs incurred by small business refiners to comply with the diesel fuel

sulfur controls imposed by the U. S. EPA.

(5) Provisions that increase taxpayer's federal adjusted gross income or taxable income, including limits on: (a) expatriation of income; (b) deductions for property leased to tax-exempt entities; (c) certain transfers of partnership losses; (d) deductions for charitable contributions of intellectual property; and (e) deductions for certain entertainment expenses relating to use of company aircraft.

Explanation of Local Expenditures:

Explanation of Local Revenues: The IRC update could potentially affect taxable income of individual taxpayers, however, the impact on counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) is likely to be minimal.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: Tom Conley, Department of State Revenue, (317) 232-2107; Bob Lain, State Budget Agency, (317) 232-3471; Larry Stroble, Barnes and Thornburg, LLP, (317) 231-7248. U. S. Congress, Joint Committee on Taxation, <http://www.house.gov/jct/tableofcnts.html>.

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